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IN THE

Supreme Court of the United States

MILWAUKEE SAFEGUARD INSURANCE COMPANY, et al.,
Petitioners,

v.

STEPHEN F. SELCKE, Director of
the Illinois Department of Insurance, et al.,
Respondents.

On Petition for a Writ of Certiorari to the Appellate Court of Illinois, First Judicial District

MOTION FOR LEAVE TO FILE AND BRIEF *AMICI CURIAE* OF THE AMERICAN INSURANCE ASSOCIATION, THE ALLIANCE OF AMERICAN INSURERS, THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, AND THE AMERICAN COUNCIL OF LIFE INSURERS IN SUPPORT OF PETITIONERS

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Amici respectfully move this Court for leave to file the attached brief *amici curiae* in support of petitioners. *Amici* requested consent to file this brief from counsel for all parties, and received consent except from counsel for the Director of the Illinois Department of Insurance and counsel for the Treasurer of the State of Illinois who failed to respond to the request for consent.

The American Insurance Association, the Alliance of American Insurers, and the National Association of Independent Insurers are three of the leading associations of

property and casualty insurers in the United States. Their members, comprised of some 1,400 insurance companies, write almost 70 percent of the property and casualty insurance underwritten in the United States, amounting to $208 billion in direct premiums written nationwide and almost $10 billion in direct premiums written in Illinois in 2000. The American Council of Life Insurers ("ACLI") is the largest life insurance trade association in the United States, representing the interests of 399 member life insurance companies of which 334 are licensed to do business in Illinois. ACLI members account for 76 percent of life insurance premiums in the United States and 77 percent of Illinois life insurance premiums. Member companies of the four *amici* trade associations range in size from small companies that operate in a single state to the largest insurers with global operations, and include companies based in Illinois and almost every other state of the United States.

These companies would be profoundly affected if, in order to obtain refunds of unlawfully discriminatory taxes, they were put to the very heavy burden of demonstrating that they had not passed on such taxes to policyholders. Such a burden should not be imposed even on an interim or transitory basis while this case is returned to the trial court for individual factual determinations of passing on for each of the 59 plaintiffs involved in the proceedings below. The insurers represented by the *amici* have an obvious interest in the prompt resolution of the legal issue presented here which involves the proper interpretation of this Court's decision in *McKesson v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990).

In addition, because the business of insurance is subject to a unique system of state taxation, the decision of the Illinois intermediate appellate court poses a greater threat to insurance companies than to non-insurance companies. So

far as we are aware, for example, insurance is the only industry subject to a nationwide regime of state retaliatory taxation. Under that system, State A must compare the tax burden on its own companies doing business in State B with the tax burden otherwise imposed by State A on companies from State B. If the tax burden in State B is higher, State A imposes a retaliatory tax in the amount of the difference. This form of taxation is now in effect in all states except Hawaii. Insurance retaliatory taxation—designed to serve as an interstate tax equalizer—dates back well over a hundred years (*see Philadelphia Fire Ass'n v. New York*, 119 U.S. 110, 111 (1886)), and was authorized by Congress and this Court more than a half-century ago in the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15 (2000), and *Prudential Insurance Co. v. Hobbs*, 328 U.S. 822 (1946) (*per curiam*). In 1981, this Court removed all doubts regarding the validity of retaliatory taxation, rejecting the dual claims that such taxation violates the Commerce Clause and the Equal Protection Clause. *See Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648 (1981). The longstanding and abiding interest of the *amici* in this form of taxation is highlighted by the fact that all four of them participated as *amici* in *Western & Southern*, urging the Court to uphold what was, even then, the well-established system of retaliatory taxation applicable to the insurance industry.

The Illinois court's decision poses a serious threat to the stability of the retaliatory tax system. For that system to function, it is necessary to make a comparison between the taxes imposed by the retaliating state and the taxes in the home state of the insurer subject to retaliation. To the extent the latter taxes are higher than the former, a retaliatory tax is imposed to equalize the taxation of companies in the two states.

The decision below raises the question whether in making the required retaliatory tax comparison, taxes that are found to have been passed-on should be counted or disregarded. In some instances, not counting such taxes would reduce an insurance company's overall taxes; in others, it would increase them. Irrespective of the possible outcomes in individual cases, however, the *amici* remain united in the belief that the retaliatory tax system, as it presently functions, fosters uniform and moderate levels of taxation, *see Western & Southern*, 451 U.S. at 668-70 & n.22, and that the uncertainty created by the decision in Illinois would have a severe adverse impact on the industry.

For the foregoing reasons, *amici* respectfully request leave to file the accompanying brief *amici curiae* in support of petitioners.

Respectfully submitted,

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF THE *AMICI CURIAE* 1

REASONS FOR GRANTING THE WRIT 1

I. ONLY THIS COURT CAN DISPEL THE CONFUSION REGARDING THE SCOPE OF A TAXPAYER'S RIGHT TO A REFUND OF AN UNLAWFULLY DISCRIMINATORY STATE TAX 4

II. THE DECISION BELOW SERIOUSLY THREATENS BOTH THE INTERESTS OF INSURERS AND THE NATIONWIDE SYSTEM OF STATE INSURANCE TAXATION 8

A. The Pass-on Defense Is a Particular Threat to Insurance Companies Because of the Unique and Complex Nature of the State Insurance Tax System .. 8

B. The Pass-on Defense Threatens to Undermine the State Retaliatory Tax System, Which Is a Critical Component of the Existing State Tax Regime for Insurers 12

C. Insurance Companies Are at Great Risk of Further Invasion of Their Constitutional Rights 16

CONCLUSION 20

TABLE OF AUTHORITIES

Page

FEDERAL CASES

Age Int'l, Inc. v. Miller,
830 F. Supp. 1484 (N.D. Ga. 1993), *aff'd mem.*,
37 F.3d 637 (11th Cir. 1994) 5

Concordia Fire Ins. Co. v. Illinois,
292 U.S. 535 (1934) 17

Cox Broadcasting Corp. v. Cohn,
420 U.S. 469 (1975) 19

Fulton Corp. v. Faulkner,
516 U.S. 325 (1996) 8

George Moore Ice Cream Co. v. Rose,
289 U.S. 373 (1933) 19

Hanover Fire Ins. Co. v. Harding,
272 U.S. 494 (1926) 3, 17

Hanover Shoe, Inc. v. United Shoe Mach. Corp.,
392 U.S. 481 (1968) 2, 8

Hobby v. United States,
468 U.S. 339 (1984) 18

Illinois Brick Co. v. Illinois,
431 U.S. 720 (1977) 8

Iowa-Des Moines Nat'l Bank v. Bennett,
284 U.S. 239 (1931) 19

TABLE OF AUTHORITIES—Continued

Lincoln Nat'l Life Ins. Co. v. Read,
325 U.S. 673 (1945) 17

McGoldrick v. Berwind-White Coal Mining Co.,
309 U.S. 33 (1940) 16

McKesson v. Division of Alcoholic Beverages & Tobacco,
496 U.S. 18 (1990) ..... *passim*

Metro. Life Ins. Co. v. Ward,
470 U.S. 869 (1985) 17

Nippert v. City of Richmond,
327 U.S. 416 (1946) 16

Philadelphia Fire Ass'n v. New York,
119 U.S. 110 (1886) 12

Prudential Insurance Co. v. Hobbs,
328 U.S. 822 (1946) 12

Reserve Life Ins. Co. v. Bowers,
380 U.S. 258 (1965) 17

S. Carolina State Highway Dep't v. Barnwell Bros., Inc.,
303 U.S. 177 (1938) 16

Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648 (1981) ..... *passim*

STATE CASES

American Trucking Ass'ns v. Conway,
566 A.2d 1323 (Vt. 1989) 6

TABLE OF AUTHORITIES—Continued

Auto. Trade Ass'n of Greater Philadelphia v. City of Philadelphia, 596 A.2d 794 (Pa. 1991) 5

Consol. Distilled Prods., Inc. v. Mahin, 306 N.E.2d 465 (Ill. 1973), *appeal dismissed*, 419 U.S. 809 (1974) 4, 5

James B. Beam Distilling Co. v. State of Georgia, 437 S.E.2d 782 (Ga. 1993), *cert. denied*, 513 U.S. 1056 (1994) 6, 7

Metro. Life Ins. Co. v. Comm'r of Dept of Ins. of N. Dakota, 373 N.W.2d 399 (N.D. 1985) 17

Milwaukee Safeguard Ins. Co. v. Selcke, 688 N.E.2d 68 (Ill. 1997) 17

PIA New Jersey, Inc. v. Div. Of Tax'n, 13 N.J. Tax 94 (1993) 5

Penn Mut. Life Ins. Co. v. Dep't of Licensing & Regulation, 412 N.W.2d 668 (Mich. Ct. App. 1987) 18

Principal Mut. Life Ins. Co. v. Div. of Ins., 780 P.2d 1023 (Alaska 1989) 17

South Cent. Bell Tel. Co. v. State, 789 So.2d 147 (Ala. 2000) 6

State ex rel. Paige v. Canady, 434 S.E.2d 10 (W. Va. 1993) 6

TABLE OF AUTHORITIES—Continued

State of S. Dakota v. Am. Bankers Ins. Co.,
374 N.W.2d 609 (S.D. 1985) 17

William Clairmont, Inc. v. State,
261 N.W.2d 780 (N.D. 1977) 6

Yellow Freight Sys., Inc. v. State of Michigan,
585 N.W.2d 762 (Mich. Ct. App. 1998), *rev'd on other grounds*, 627 N.W.2d 236 (Mich. 2001), *cert. granted in part on an unrelated issue*,
122 S. Ct. 918 (2002) 5

STATUTES

Federal

McCarran-Ferguson Act,
15 U.S.C. §§ 1011-15 (2000) 13, 14

State

Alabama Code § 27-3-29(b) 16
Ariz. Rev. Stat. §§ 20-224, 20-226 9
Ark. Code § 26-57-601 10
Calif. Ins. Code § 658(a) 16
Del. Code Ann. tit. 18 § 712 9
Del. Code Ann. tit. 19 § 2392 10
Florida Stat. § 624.509 9
Illinois Compiled Stat., 215 ILCS 5/409(1) 14
Ind. Code § 6-3-8-2(b) 9
Kan. Stat. Ann. § 44-566a(b) 10
Tex. Ins. Code art. 21.28-C 10

TABLE OF AUTHORITIES—Continued

LEGISLATIVE MATERIALS

Proposed Amendment No. 2 to Illinois Senate Bill 1126.....7

TREATISES AND ARTICLES

Coverdale, John F., *Remedies for Unconstitutional State Taxes*, 32 Connecticut L. Rev. 73 (2000).....6

Rakowski, Eric, *Harper and Its Aftermath*, 1 Fla. Tax. Rev. 445 (1993).....6

Tribe, Laurence H., American Constitutional Law (2d ed. 1988).....16

Viard, Alan D., *Pass-On Defense Doesn't Pass Muster*, 52 Tax Notes 1094 (1993).....6

INTEREST OF THE *AMICI CURIAE*

The interest of the *amici curiae* is set forth in the accompanying motion for leave to file this brief.[1]

REASONS FOR GRANTING THE WRIT

This Court ruled unanimously in *McKesson v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990), that a state may not seek to defeat recovery of an unconstitutionally discriminatory tax paid under protest by requiring the taxpayer to show that the tax was not "passed on" to customers. The Court held that the pass-on defense fails to meet the minimum standard of due process, which requires a clear and certain remedy where a state has exacted an unlawfully discriminatory tax. *Id.* at 48-49.

As demonstrated by the decision below, however, divergent state court rulings have created doubt as to the scope of *McKesson*. While some state courts have faithfully followed the Court's ruling in *McKesson*, others have purported to find a continuing role for the pass-on defense, notwithstanding this Court's clear statement to the contrary in *McKesson*. By failing to follow *McKesson*, the Appellate Court of Illinois has created fresh uncertainties about the applicable due process remedial requirements in state tax cases. This confusion concerning the correct reading of

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[1] This brief was not authored in whole or in part by counsel for a party to this proceeding, and no person or entity other than the *amici curiae*, their members, or their counsel made a monetary contribution to the preparation or submission of this brief. A number of the petitioners and the non-petitioner plaintiffs are members of one or more of the *amici* trade associations, but none of them has made a monetary contribution to the preparation or submission of this brief beyond that of other members of the trade association.

McKesson threatens to undermine the uniform application of due process standards across the nation by creating a patchwork system in which the treatment of an individual taxpayer varies arbitrarily from state to state.

This attempt to resurrect the pass-on defense not only affects the interests of taxpayers in general, but poses particular risks for the national insurance industry. Indeed, the *amici* are concerned that the decision below seriously jeopardizes the unique system of state taxation that applies to insurance companies, as well as the interests of insurers in being free from unconstitutionally discriminatory taxes.

First, the pass-on defense is particularly pernicious when applied to insurance companies because the complex interlocking system of state insurance taxation (involving premium, income and retaliatory taxes, various special purpose assessments and cross-tax credits) makes it especially difficult to discern whether any specific element of tax was passed on to policyholders. For insurers, this compounds the "nearly insuperable difficulty" the Court has identified in other contexts when a company is called upon to prove that it did not pass on a particular cost to customers. *See Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481, 491-94 (1968). The result is that states may find insurance companies even more inviting targets for unlawful tax discrimination, simply because they are so poorly positioned from an evidentiary perspective to overcome the pass-on defense.

Second, the pass-on defense poses a serious risk to the long-established regime of state retaliatory taxation. The fundamental premise of the retaliatory tax system is that a comparison can readily be made between the tax burden in the retaliating state and the tax that would be imposed on a company from the retaliating state doing business in another state. If, however, state courts begin applying the pass-on defense to hold that particular insurance companies did not

absorb the burden of discriminatory taxes, the straightforward comparison that has undergirded the retaliatory tax system for more than a century becomes clouded with uncertainty, and the entire system may begin to unravel. For insurance companies—which lack the protections against burdensome and discriminatory taxation afforded by the negative Commerce Clause—the results could be highly disruptive and potentially even catastrophic.

Third, states (including Illinois) have a long history of imposing unlawfully discriminatory taxes on insurers. *See, e.g., Hanover Fire Ins. Co. v. Harding*, 272 U.S. 494 (1926). Out-of-state insurance companies in particular present an inviting target for states seeking additional revenues because they typically have limited political influence relative to the domestic insurers of the state and because their presence in the state makes it easy to tax them. If the decision below is followed in other states, this will increase the likelihood that states will enact, or maintain, taxes of dubious constitutionality in hopes of collecting added revenue today and avoiding subsequent refund liability by invoking the pass-on defense.

In short, immediate review by this Court is urgently needed to restore certainty to this important area of the law. A taxpayer's right under the Due Process Clause to a clear and certain remedy for unconstitutional discrimination should not depend on the fortuity of the state in which the claim is brought. Nor, at a time of tightened state budgets, should states be encouraged to seek revenues in ways that would be deterred—and properly so—by the prospect of paying refunds to taxpayers unfairly assigned a disproportionate share of the state's tax burden. Only this Court can end the widening confusion on this issue, prevent further erosion of the due process rights of taxpayers, and halt the growing threat to the constitutional rights of insurers and others who

may become the targets of further unlawful discrimination if due process remedial requirements are weakened.

I. ONLY THIS COURT CAN DISPEL THE CONFUSION REGARDING THE SCOPE OF A TAXPAYER'S RIGHT TO A REFUND OF AN UNLAWFULLY DISCRIMINATORY STATE TAX

The *McKesson* Court directly addressed—and squarely rejected—the pass-on defense adopted by the Illinois intermediate appellate court in this case. The Court explained that where the constitutional infirmity of a tax is its discriminatory character, the taxpayer's complaint is not that too much tax has been imposed *per se* but rather that the tax places the taxpayer at a "relative disadvantage in the marketplace vis-à-vis [local] competitors. . . ." *See McKesson*, 496 U.S. at 48. This competitive disadvantage cannot be overcome merely by passing on the tax through higher prices, because the taxpayer inevitably either loses sales to in-state competitors or incurs other costs (*e.g.*, advertising) to maintain its market share despite higher prices. *See id.* at 48. As a result, the Court held that equitable considerations do not entitle a state "to retain tax moneys taken unlawfully from petitioner due to its pass-on of the tax where the pass-on itself furthers the very competitive disadvantage constituting the [constitutional] violation that rendered the deprivation unlawful in the first place." *Id.* at 48-49; *see also id.* at 42-43.[2]

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[2] Although the *McKesson* Court left open the question whether a pre-existing state-law immunity bar could be asserted by a state in certain circumstances, *see* 496 U.S. at 49 n.34, there is no credible basis in this case to find any such state-law immunity bar in pre-existing Illinois law. *Consol. Distilled Prods., Inc. v. Mahin*, 306 N.E.2d 465 (Ill. 1973), *appeal dismissed*, 419 U.S. 809

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State courts, however, have not interpreted *McKesson* uniformly. On the one hand, courts in Michigan and Pennsylvania recognized that the Court rejected the pass-on defense in tax discrimination cases. *See Yellow Freight Sys., Inc. v. State of Michigan*, 585 N.W.2d 762, 767 (Mich. Ct. App. 1998) ("[T]he *McKesson* Court ultimately rejected the [pass-on] defense in that case. The state has not cited any authority indicating that the pass-on defense has been adopted in this jurisdiction, and we decline to adopt it in this case.") (citation omitted), *rev'd on other grounds*, 627 N.W.2d 236 (Mich. 2001), *cert. granted in part on an unrelated issue*, 122 S. Ct. 918 (2002); *Auto. Trade Ass'n of Greater Philadelphia v. City of Philadelphia*, 596 A.2d 794, 796 (Pa. 1991) (explaining that *McKesson* rejected the pass-on defense on the reasoning that "a pass-on of excess costs was precisely the competitive disadvantage imposed on out of state products that the Commerce Clause was designed to prevent.").[3] Legal commentators similarly have concluded

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(1974), relied upon by the court below, allowed the State of Illinois to invoke the pass-on defense on equitable, not sovereign immunity, grounds. In *Consol. Distilled Prods.*, the Illinois Supreme Court held that the state's general policy against unjust enrichment required the taxpayer to make a showing that it had borne the burden of the tax, even though the liquor tax statute at issue did not impose such a requirement. *See id.* at 469.

[3] *See also Age Int'l, Inc. v. Miller*, 830 F. Supp. 1484, 1498 (N.D. Ga. 1993) ("even if Plaintiffs 'pass on' the tax to subsequent customers, and ultimately the consumer, Plaintiffs are still economically disadvantaged by the [higher tax]."), *aff'd mem.*, 37 F.3d 637 (11th Cir. 1994); *PIA New Jersey, Inc. v. Div. Of Tax'n*, 13 N.J. Tax 94, 101 (1993) (recognizing that *McKesson* rejected the pass-on defense in tax discrimination cases where it was necessary to remedy the competitive disadvantage suffered by the taxpayer, but declining to extend the *McKesson* holding to a case

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that *McKesson* definitively rejected pass-on as a defense to redressing an unlawfully discriminatory tax.[4]

On the other hand, a number of state courts have adopted a reading of *McKesson* under which they assert that the pass-on defense is still allowed in tax discrimination cases.[5] This

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where the tax was held invalid under the First Amendment). *Compare American Trucking Ass'ns v. Conway*, 566 A.2d 1323, 1334 (Vt. 1989) (holding state must refund the taxes paid, regardless of the fact that the refund might constitute an unjust enrichment to the taxpayer); *William Clairmont, Inc. v. State*, 261 N.W.2d 780, 785 (N.D. 1977) (same).

[4] *See, e.g.*, Alan D. Viard, *Pass-On Defense Doesn't Pass Muster*, 52 Tax Notes 1094, 1095 (1993) (arguing that *McKesson* involved a "substantive rejection of the pass-on defense"); John F. Coverdale, *Remedies for Unconstitutional State Taxes*, 32 Connecticut L. Rev. 73, 136 n.180 (2000) ("[T]he Court rejected [the] passing-on defense[] in *McKesson* rather than remanding it for further fact-finding [which] suggests . . . that it intended the rule to apply as a matter of law."). *Cf.* Eric Rakowski, *Harper and Its Aftermath*, 1 Fla. Tax. Rev. 445, 504-07 (1993) (suggesting that it is not clear what conclusion the Court would reach in cases where the state could show that the taxpayer suffered no injury at all, perhaps because it functioned exclusively under cost-plus contracts).

[5] *See South Cent. Bell Tel. Co. v. State*, 789 So.2d 147, 149 (Ala. 2000) (remanding for "information as to the extent to which the [petitioners] have borne the economic impact of the excess franchise taxes collected, so that [the court could] consider the legal effect of any passing through of the burden to customers"); *State ex rel. Paige v. Canady*, 434 S.E.2d 10, 14 (W. Va. 1993) (ordering the taxpayer to show that the tax was not passed on or that the pass-on affected the taxpayer's marketplace performance); *James B. Beam Distilling Co. v. State of Georgia*, 437 S.E.2d 782, 784 (Ga. 1993) (holding that a remitting party that passes on the

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erroneous interpretation is exemplified by the decision below. The Illinois appellate court concluded that *McKesson* "did not preclude the use of the pass-on defense in a discrimination tax case" but rather gave the states "flexibility" to invoke passing-on as an equitable defense whenever preexisting state precedent recognized such a defense. App. 11, 13. Finding such precedent to exist in Illinois, the court ruled that *McKesson*'s rejection of the pass-on defense did not apply.[6]

The manifest confusion in the states concerning the proper interpretation of *McKesson* requires clarification by this Court. Minimum requirements of due process are not a matter of local discretion or option, and the question of refunds of discriminatory state taxes is too pervasive and important to be left to conflicting state rules. Taxpayers are entitled to a uniform standard regardless of the state where their claims arise. Only this Court can restore uniformity and predictability in this critical area of the law.

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tax lacks standing under the state refund statute), *cert. denied*, 513 U.S. 1056 (1994). Notably, when the Court denied certiorari in *Beam*, the full extent of the disarray in the state courts on this issue was not yet evident.

[6] Last year, during the pendency of this case, the Illinois legislature considered but did not enact a provision to codify the pass-on defense. *See* Proposed Amendment No. 2 to Illinois Senate Bill 1126.

II. THE DECISION BELOW SERIOUSLY THREATENS BOTH THE INTERESTS OF INSURERS AND THE NATIONWIDE SYSTEM OF STATE INSURANCE TAXATION

A. The Pass-on Defense Is a Particular Threat to Insurance Companies Because of the Unique and Complex Nature of the State Insurance Tax System

As this Court recognized in *McKesson*, "determining whether a particular business cost has in fact been passed on to customers or suppliers entails a highly sophisticated theoretical and factual inquiry. . . ." 496 U.S. at 47. Under the best of circumstances, this exercise is fraught with "theoretical, factual, and practical difficulties," *id.* at 47 n.31, which are likely to result in "'long and complicated proceedings involving massive evidence and complicated theories.'" *Id.* (quoting *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 493 (1968)). Indeed, the Court has rejected pass-on arguments in antitrust cases precisely because of the "nearly insuperable difficulty" in proving whether a particular cost has or has not been passed on. *Hanover Shoe*, 392 U.S. at 493; *see also Illinois Brick Co. v. Illinois*, 431 U.S. 720, 725 n.3, 736-43 (1977) (noting that a demonstration of the economics of "passing on" requires a showing of "virtually unascertainable figures"); *Fulton Corp. v. Faulkner*, 516 U.S. 325, 341-42 (1996) (citing "the frequently extreme complexity of economic incidence analysis").

The decision below, if allowed to stand, promises to lead to precisely the kind of "long and complicated proceedings involving massive evidence and complicated theories" that the Court described in *Hanover Shoe*. Indeed, the usual difficulties encountered in judicial efforts to determine whether a particular cost has been passed on are compounded

in the case of insurance company taxpayers by the unique system of insurance taxation that prevails in Illinois and other states.

In the vast majority of states, the primary state tax imposed on insurance companies is the gross premium tax. This tax is typically "set at a fixed percentage of premiums paid on insurance policies issued in the State." *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 649-50 (1981). The premium tax is comparable to a gross receipts tax in that it is imposed whether or not the particular insurance company taxpayer earns a profit on the business subject to tax. Although statutes in many states provide that the premium tax is imposed "in lieu of" other general business taxes,[7] insurers are also customarily subject to a number of other taxes and assessments. These include (at least in some states) net income taxes, which may or may not be credited against the premium tax,[8] premium taxes, which may or may not be credited against the income tax,[9] and various kinds of special purpose assessments. Among the types of special purposes for which assessments are imposed

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[7] *E.g.*, Ariz. Rev. Stat. §§ 20-224, 20-226 (premium taxes shall be in lieu of all other business taxation including investment income, except for taxes on real and tangible personal property located within the state); Del. Code Ann. tit. 18 § 712 (premium taxes shall be in lieu of all county and municipal license fees and taxes, except property taxes).

[8] *E.g.*, Florida Stat. § 624.509 (allowing insurance companies to credit their Florida corporate income taxes against their premium tax liability).

[9] *E.g.*, Ind. Code § 6-3-8-2(b) (allowing insurance companies in certain circumstances to deduct premium taxes in computing corporate net income tax).

are state guaranty funds established to secure claims by policyholders in the event of insurance company insolvencies, workers compensation funds and administration, second injury funds, fire training academies, fire and police pension funds, fraud prevention, and insurance department administration.[10] Liability for these taxes and assessments is imposed solely on the insurance company and not on individual policyholders. As in the case of premium taxes, special purpose assessments are generally imposed as a fixed percentage of premiums on policies issued in the state, although the percentage may vary from year to year depending upon the needs of the fund to which the special purpose assessments relate.[11]

Finally, as discussed elsewhere in this brief, virtually every state imposes a retaliatory tax on out-of-state insurers "set in response to the insurance tax laws of the insurer's home State." *Western & Southern*, 451 U.S. at 650. As this Court described the mechanics of the retaliatory tax in California:

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[10] *E.g.*, Ark. Code § 26-57-601 (additional tax on casualty companies writing workers' compensation insurance); Tex. Ins. Code art. 21.28-C (establishing a guaranty fund to be financed through assessments on insurance carriers for the purpose of paying "impaired" insurers' obligations).

[11] *E.g.*, Kan. Stat. § 44-566a(b) (imposing annual assessments in the amount of money paid or payable in worker's compensation claims by the insurance carrier in the preceding calendar year); Del. Code Ann. tit. 19 § 2392 (imposing semi-annual assessments in the amount of all worker's compensation payments and awards paid by insurance carriers during the preceding calendar year).

> In computing the retaliatory tax owed by a given out-of-state insurer, California subtracts the California taxes otherwise due from the total taxes that would be imposed on a hypothetical similar California company doing business in the out-of-state insurer's State of incorporation. If the other State's taxes on the hypothetical California insurer would be greater than California's taxes on the other State's insurer, a retaliatory tax in the amount of the difference is imposed

Id. at 650-51. In other words, on top of the other taxes and assessments described above, an out-of-state insurer may face an additional tax (the retaliatory tax) whose sole purpose is to equalize the aggregate tax burden between the two states (*i.e.*, the retaliating state and the insurer's home state).

The combination of these disparate taxes imposed on the same company vastly complicates the already daunting task of showing whether a particular tax was or was not passed on to customers. Indeed, it is difficult to envision what evidence an insurance company can adduce at trial to prove with any degree of exactitude either that it did not pass along any of the discriminatory tax increment, or if that burden cannot be met, what portion of the tax could not be shifted to others. For many of the plaintiff companies in this case, the Illinois appellate court's remand for a trial on the pass-on issue may prove to be a purely illusory benefit, since they will not ultimately be able to overcome the evidentiary obstacles to making the requisite showing. Nor is that situation unique to this case. If the pass-on defense is permitted generally, insurance companies will become even more inviting targets for tax discrimination because states can reasonably anticipate that few companies will obtain tax refunds in the face of the pass-on defense. This Court should review the

decision below to prevent such an erosion of due process and related constitutional rights.

B. The Pass-on Defense Threatens to Undermine the State Retaliatory Tax System, Which Is a Critical Component of the Existing State Tax Regime for Insurers

The retaliatory tax system, which currently applies to insurance companies in all states except Hawaii, dates back to the Civil War era. *See Philadelphia Fire Ass'n v. New York*, 119 U.S. 110, 111 (1886). The validity of retaliatory taxation as applied to insurers has been sustained by this Court on numerous occasions stretching over more than a century. *See Prudential Ins. Co. v. Hobbs*, 328 U.S. 822 (1946) (*per curiam*); *Western & Southern*, 451 U.S. 648. This comprehensive system of mutual retaliation functions effectively because the action of any one state to place extraordinary burdens on companies from other states is matched by equivalent burdens on the companies of the taxing state in the other states in which those companies do business. As a result, as the Court stated in *Western & Southern*, "[a]lthough the retaliatory tax is an imposition on interstate insurance companies, it is supported by the industry as a means of fostering uniform and moderate levels of taxation nationwide." 451 U.S. at 669 n.22.

The Court went on to explain in *Western & Southern* that, "[s]ince the amount of revenue raised by the retaliatory tax is relatively modest . . . and the impetus for passage of the tax comes from the nationwide insurance industry, it is clear that the purpose [of retaliation] is not to generate revenue at the expense of out-of-state insurers, but to apply pressure on other States to maintain low taxes on [the retaliating state's] insurers." *Id.* at 669-70 (citations omitted). Although the Court noted that "many persons believe that retaliatory taxes are not an effective means for accomplishment of the goal of deterring discriminatory and excessive taxation of insurance

companies by the various States," *id.* at 671, it concluded that the California legislature could reasonably have concluded otherwise. "Assuming that the lawmakers of each State are motivated in part by a desire to promote the interests of their domestic insurance industry," the Court observed, "it is reasonable to suppose that California's retaliatory tax will induce other States to lower the burdens on California insurers in order to spare their domestic insurers the cost of the retaliatory tax in California." *Id.* at 672.

Notwithstanding their legitimate purpose, such retaliatory taxes would almost certainly fall afoul of the Commerce Clause if they were applied to virtually any other interstate business. However, Congress in the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15 (2000), "removed all Commerce Clause limitations on the authority of the States to regulate and tax the business of insurance." *Western & Southern*, 451 U.S. at 653. As a result, the Court "has squarely rejected the argument that discriminatory state insurance taxes may be challenged under the Commerce Clause," *id.* at 654, and has sustained state retaliatory taxes against Commerce Clause challenges on precisely that ground. *Id.* at 654-55 (citing *Prudential Ins. Co. v. Hobbs*, 328 U.S. 822 (1946) (*per curiam*)).

The inapplicability of the Commerce Clause to the insurance industry has another important implication in the context of retaliatory taxation. Under the McCarran-Ferguson Act, insurance companies lack the protection from burdensome or discriminatory taxes that other interstate businesses enjoy as a matter of course. The retaliatory tax regime—which evolved at a time when the insurance business was not viewed as "interstate commerce"—functions in effect as a surrogate for the protections otherwise afforded by the Commerce Clause. As described above, the purpose of the retaliatory tax system is to use each state's parochial interest in furthering the interests of its own

domestic insurers as a means to moderate the incentives for other states to impose burdensome or discriminatory taxes on out-of-state companies. *Amici* believe this system, despite its imperfections, is effective in making more workable and more fair the scheme of relatively unfettered state taxation of insurers embodied in the McCarran-Ferguson Act.[12]

The pass-on defense recognized by the Illinois court threatens to undermine the clarity and practicality that are the cornerstones of the effective functioning of the retaliatory tax system. If the Illinois courts ultimately determine that some or all of the challenged premium taxes in this case were passed on to policyholders, that will raise serious questions about the applicability of the retaliatory tax, both in Illinois and in other states. For example, during the years in question, Illinois imposed a 2.0 percent gross premium tax on insurers from other states. App. 26 (citing 215 ILCS 5/409(1)). Putting to one side any other taxes or fees in the respective states, Illinois ordinarily would not have imposed any retaliatory tax on companies from states with a premium tax of 2.0 percent or less on Illinois (and other out-of-state) companies. However, if the Illinois courts conclude that the 2.0 percent premium tax in Illinois was not absorbed by the insurer but rather was passed on to customers, what would prevent Illinois from seeking to impose a retaliatory tax on an out-of-state company from a state with only a 1.5 percent premium tax rate? In other words, when Illinois compares

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[12] Of course, state taxation of insurers is not totally unconstrained by the Constitution. As the Court observed in *Western & Southern*, although Congress in the McCarran-Ferguson Act lifted the Commerce Clause limitations on state taxation of insurers, it did not alter "constitutional standards other than those derived from the Commerce Clause," 451 U.S. at 655 n.6, such as equal protection and due process standards.

the tax burdens in the two states, why could it not conclude that the tax burden in Illinois is effectively zero (on the basis that the 2.0 percent tax was passed on), that the tax burden in the other state is 1.5 percent of premiums, and that this leads inevitably to a 1.5 percent retaliatory tax?[13]

Conversely, Illinois insurers in this scenario might seek to avoid retaliation in other states by contending that the Illinois premium tax is not a burden on out-of-state companies because of the Illinois courts' determination that the tax burden was passed through to customers. In other words, in a state where the basic premium tax rate is 1.5 percent, Illinois insurers would normally face a retaliatory tax (disregarding any other applicable taxes or fees) of 0.5 percent of premiums (*i.e.,* Illinois' 2.0 percent premium tax rate minus 1.5 percent). However, in the wake of a pass-on ruling, why could the Illinois insurers not argue that the tax burden in Illinois on companies from the 1.5 percent state is effectively zero, not 2.0 percent, and therefore that no retaliatory tax should apply?[14]

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[13] Moreover, in this scenario, the possibility of mutually escalating retaliation is presented. The 1.5 percent state, faced with Illinois' calculation, may disagree on the pass-on issue, and determine that its companies are being charged 3.5 percent in Illinois, leading to imposition of a 2.0 percent retaliatory tax on Illinois insurers on top of the 1.5 percent rate otherwise applicable. In such a scenario, there is no logical stopping point to the ultimate retaliatory tax burden each state may seek to impose.

[14] *Amici* are also concerned that other states may begin retaliating against insurers domiciled in Illinois (including members of the *amici* trade associations) by requiring them to meet the Illinois pass-on standard before receiving refunds of taxes paid in other states. The likelihood of this proliferation of pass-on defenses occurring is real and foreseeable. Retaliatory statutes are

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These and other troubling questions threaten to disrupt and complicate what has historically been a straightforward and smoothly functioning system. If pursued to their logical conclusion, the arguments put forward by Illinois in this case could result either in vastly expanded retaliation and an ever-increasing burden on insurers (with no greater contribution to the legitimate goals of the retaliatory tax) or widespread avoidance of retaliation, with a substantial weakening of the protections afforded by the retaliatory tax system. In either event, the implications for the insurance industry are potentially devastating, and the need for this Court to act to resolve the current confusion over the purported pass-on defense is all the more urgent.

C. Insurance Companies Are at Great Risk of Further Invasion of Their Constitutional Rights

As the Court has long recognized, states have a natural tendency to favor local interests over out-of-state ones, even when the protections afforded by the Commerce Clause, the Equal Protection Clause, or the Privileges and Immunities Clause are implicated. *See Nippert v. City of Richmond*, 327 U.S. 416, 433-34 (1946); *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 45-46 n.2 (1940); *S. Carolina State Highway Dep't v. Barnwell Bros., Inc.*, 303 U.S. 177, 184-85 n.2 (1938); *see also* Laurence H. Tribe, American Constitutional Law § 6-5, at 409 (2d ed. 1988) ("[S]tate and local lawmakers are especially susceptible to pressures which may lead them to make decisions harmful to the commercial

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generally not limited to taxes but also apply to "other material obligations, prohibitions, or restrictions," *see e.g.*, Ala. Code § 27-3-29(b); Calif. Ins. Code § 658(a), including potentially the obligation to demonstrate, in order to recover refunds, that taxes were not passed on.

interests of those who are not constituents of their political subdivisions.").

In fact, there is a long and persistent pattern of states imposing discriminatory taxes on insurers that have been ruled unconstitutional by this Court and various state courts. *See Reserve Life Ins. Co. v. Bowers*, 380 U.S. 258 (1965) (*per curiam*) (invalidating a discriminatory state insurance tax on equal protection grounds); *Concordia Fire Ins. Co. v. Illinois*, 292 U.S. 535 (1934) (invalidating a state law that taxed certain foreign insurance companies at a different rate than domestic companies); *Hanover Fire Ins. Co. v. Harding*, 272 U.S. 494 (1926) (invalidating a discriminatory Illinois privilege tax on out-of-state insurers); *cf. Metro. Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (addressing a discriminatory Alabama insurance tax and holding that the two primary purposes advanced for it were not legitimate state purposes); *Lincoln Nat'l Life Ins. Co. v. Read*, 325 U.S. 673 (1945) (upholding a discriminatory state tax on insurers under the now-discredited "privilege tax doctrine").[15]

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[15] *See also Principal Mut. Life Ins. Co. v. Div. of Ins.*, 780 P.2d 1023, 1025 (Alaska 1989) (invalidating on federal equal protection grounds an Alaska statute that "imposes a higher tax on foreign insurance companies than on domestic insurance companies"); *Milwaukee Safeguard Ins. Co. v. Selcke*, 688 N.E.2d 68 (Ill. 1997) (invalidating on state uniformity clause grounds an Illinois statute imposing a higher tax on out-of-state insurers than in-state insurers); *Metro. Life Ins. Co. v. Comm'r of Dept of Ins. of N. Dakota*, 373 N.W.2d 399, 406 (N.D. 1985) (invalidating on federal equal protection grounds a "North Dakota statutory scheme for taxing insurance companies [that] placed a more onerous burden on foreign-incorporated companies than was placed on domestic-incorporated companies"); *State of S. Dakota v. Am. Bankers Ins. Co.*, 374 N.W.2d 609, 615-17 (S.D. 1985) (invalidating on federal equal protection grounds a South Dakota

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The threat of refund claims is a powerful deterrent to state actions that would otherwise undermine important national interests, including the protection of interstate business and the even-handed treatment of taxpayers. "For if constitutional rights are to be anything more than pious pronouncements, then some measurable consequence must be attached to their violation." *Hobby v. United States*, 468 U.S. 339, 359-60 (1984) (Marshall, J., dissenting) (internal quotations and citation omitted). If states enact tax laws that discriminate against interstate business, to the advantage of local business, and then are able to avoid liability for the harm to taxpayers engaged in interstate business, the states will have little incentive to enact constitutional legislation. The prospect of raising a disproportionate share of the state's needed revenue from out-of-state or other disfavored taxpayers, and then retaining the unlawfully exacted tax because the taxpayer cannot overcome the pass-on defense, undoubtedly will fuel efforts to favor local interests and encourage actions that put important national interests—as well as the rights of taxpayers—at risk.

Moreover, the pass-on defense was rejected in *McKesson* precisely because it serves to perpetuate rather than redress the original constitutional violation. As the Court explained in *McKesson*, the pass-on defense fails to provide an adequate remedy for unconstitutionally discriminatory taxation and bestows an unwarranted windfall on the state.

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statute that imposed a higher tax burden on unlicensed insurers doing business in the state than on either licensed out-of-state insurers or licensed domestic insurers); *Penn Mut. Life Ins. Co. v. Dep't of Licensing & Regulation*, 412 N.W.2d 668, 672 (Mich. Ct. App. 1987) (invalidating on federal equal protection grounds a Michigan insurance tax statute that imposed a more burdensome tax on out-of-state insurers than in-state insurers).

The remedy is inadequate because, even if all or part of the tax is passed on, the taxpayer suffers competitive harm when (as in this case) other similarly situated taxpayers did not bear the same tax burden. *See McKesson*, 496 U.S. at 48-49 & nn.32-33.[16] The state receives a windfall because the customers of the taxpayer are unlikely to pursue their miniscule individual claims (even assuming they had standing to do so, given that they were not the parties discriminated against), and the net result is that the state is rewarded for its own unlawful conduct. *See generally* 496 U.S. at 42-43, 46, 48-50.[17] In short, unless states are required to provide the clear and certain remedy mandated by *McKesson*, insurers are placed at heightened risk of unlawfully discriminatory taxation.[18]

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[16] Although *McKesson* involved discriminatory taxation under the Commerce Clause, the same reasoning applies in cases that involve equal protection or uniformity clause analysis. *Cf. Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931) ("The right invoked is that to equal treatment; and such treatment will be attained if either their competitors' taxes are increased or their own reduced."), *quoted with approval in McKesson*, 496 U.S. at 36.

[17] The finding of the court below that plaintiffs would obtain a "windfall" rests upon an unusual view of the equities, since it presumes that the State has an equitable interest in retaining unconstitutional taxes. As Justice Cardozo noted, a government should have no interest in retaining taxes that it has unlawfully collected. *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 378-79 (1933).

[18] The pass-on issue decided by the Illinois court is ripe for review notwithstanding that further proceedings have been ordered in the state courts. This case falls within the limited set of situations identified in *Cox Broadcasting Corp. v. Cohn*, 420 U.S.

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CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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469 (1975), in which the decision of a state court is treated as effectively final notwithstanding the prospect of further state court action. In particular, petitioners have already prevailed on the merits of their constitutional claims before the highest state court in Illinois, App. 25-66, and the only remaining issue is the extent of their remedy. If this Court applies *McKesson* and reverses the lower court's ruling on the pass-on issue, further proceedings on the pass-on issue will be unnecessary. Moreover, failure to provide immediate review carries with it a substantial risk of eroding federal policies, both by denying petitioners a clear and certain remedy for the constitutional violation that occurred in this case and by undermining the effectiveness of constitutional constraints on state taxation generally.